IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED:06.03.2006

CORAM

THE HON'BLE MR.JUSTICE R.BALASUBRAMANIAN
&
THE HON'BLE MR.JUSTICE P.P.S.JANARTHANA RAJA

TAX CASE (APPEAL) NO.366 OF 2001

The Commissioner of Income Tax
Madurai ..Appellant

Vs.

Sujatha Jewellers
105 A, South Avani Moola Street
Madurai - 625 001 ..Respondent

Prayer: Appeal against the order of the Income Tax Appellate Tribunal, Madras Bench "A" dated 22.10.1999 in ITA.No.4462/MDS/1989 against the order of the Commissioner of Income Tax (A) I Madurai Range, Madurai and made in IT Appeal No.43/1989 - 90 - PA.No.49 - 003/PV 7902 against the order of the Deputy Commissioner of Income Tax Special Range I Madurai PAN.49-003-F VCV 902/1986-87 dated 29.3.1989.

For Appellant : Mrs.Pushya Sitaraman
For Respondent : No Appearance

JUDGMENT

(Judgment of the court was delivered by
Justice R.Balasubramanian)

Revenue is the appellant in this appeal, which stands admitted on the following question of law:

"Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in holding that the transaction of lease and sub-lease involved herein is not a transfer falling within the definition under section 2(47) of the Income Tax Act, 1961 and in deleting the addition of Rs.8,26,876/- assessed as short term capital gains?"

2. The following facts are not in dispute:

"The assessee has taken on lease an immovable property at No.123, Usman Road, Madras, under a lease agreement dated 06.09.1985. Under that agreement, the assessee has to pay a sum of Rs.10 lakhs to the lessor as interest free advance; the lease is to be for a period of

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22 years; rent for the first 15 years is fixed at Rs.20,350/- per month and for the remaining seven years, the monthly rent payable is Rs.84,428/-; there is a renewal clause; the assessee has sub-leased the property by lease deed dated 10.09.1985 in favour of another company for a period of 20 years; under that sub-lease agreement, the sub-lessee has to pay a sum of Rs.10 lakhs as interest free advance to the assessee; the rent payable for the first 15 years is Rs.77,500/- per month and for the remaining period, the rent payable is Rs.92,500/- per month."

2. On the above noted admitted facts, the question that was raised before the Deputy Commissioner of Income Tax was, whether transfer of leasehold rights in the land by the assessee in favour of the sub-lessee would amount to transfer of a capital asset at the hands of the assessee and if so, the consideration paid by the sub-lessee to the assessee would part-take the character of capital gains and assessable to tax as such? The Assessing Officer held that transfer of lease by the assessee would amount to transfer of a capital asset; the consideration received by the assessee under that transaction would part-take the character of capital gains and therefore liable to tax. The assessee went up in appeal before the Commissioner of Income Tax, who, by his order dated 25.09.1989 in I.T.A.No.43/1989-90, found that there was no transfer of capital asset by the assessee when he sub-leased the property in favour of a third party and therefore no capital gain is involved at the hands of the assessee in respect of the transfer effected by him as indicated earlier. Revenue went up in appeal before the Income Tax Appellate Tribunal in I.T.A.No.4462/MDS/1989 and the Appellate Tribunal agreed with the findings of the Commissioner of Income Tax. The assessment year concerned in this case is 1986-87.

3. Though the respondent has been served, they are neither appearing in person nor engaged any counsel. Heard the learned counsel appearing for the appellant. Learned counsel for the appellant, by taking us through the defenition of "capital asset" in section 2(14) of the Income Tax Act, would contend that the property of any kind in the hands of the asessee, except those provided in that section itself, would be a "capital asset". Therefore the leasehold interest of the assessee is a capital asset. Then she took us through section 45 of the Income Tax Act. A reading of that section shows that "any profits or gains arising from the transfer of a capital asset effected in the previous year shall, ... be chargeable to income tax under the head "capital gains" and shall be deemed to be the income of the previous year in which the transfer took place". She also took us through section 2(47) of the Income Tax Act highlighting as to what "transfer" means. The expression "transfer" is defined in section 2 (47) of the Income Tax Act, among other things, as hereunder:

> "the extinguishment of any rights therein (sub-clause (ii) of sub-section 47 of section 2)".

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4. Therefore her submission is that, the assessee had acquired an interest in the land by having the lease in his favour; by sub-leasing the property, he had transferred the interest in the land in favour of a third party; by such sub-lease, the assessee's rights in the capital asset had been extinguished; there is an element of transfer of a capital asset in the hands of the assessee and therefore any gains or profits made out of such transfer has to be brought under the caption "capital gains" and accordingly taxed. Learned counsel brought to our notice the following judgments to contend that transfer of a lease would amount to transfer of a capital asset.

(a) 172 ITR SC Pg.311 (R.K.Palshikar (HUF) Vs. Commissioner of Income Tax;

(b) 176 ITR SC Pg.417 (A.R.Krishnamurthy Vs. Commissioner of Income Tax, Madras);

(c) 117 ITR (Cal.) Pg.581 (A.Gasper Vs. Commissioner of Income Tax);

(d) 192 ITR SC Pg.382 (A.Gasper Vs. Commissioner of Income Tax);

(e) 133 ITR (Mad.) Pg.922 (A.R.Krishnamurthy & A.R.Rajagopalan Vs. Commissioner of Income Tax, Madras); and

(f) 202 ITR Pg.298 (Commissioner of Income Tax Vs. Pramia Engineering Private Limited).

5. Let us now examine the case on merits. It is needless to state that transferring an immovable property by way of a lease creates an interest in the land. According to section 2(14) of the Income Tax Act, the word "capital asset" means, "property of any kind held by an assessee". Therefore it does not necessarily mean that the property, which the assessee holds, must be his own. As per the above referred to definition, any kind of property held by an assessee would come within the definition of "capital asset". It is not possible to read the definition of "capital asset" in a restrictive manner to mean that the property which the assessee owned by himself alone would come within the meaning of "capital asset". In 133 ITR (Mad.) Pg.922 referred to above, a point arose before this court at the instance of the assessee as to whether transfer by way of a lease would amount to transfer of a "capital asset"? In that case, the assessee was a body of individuals, who had purchased various extents of properties in the year 1966 for a stated consideration. Thereafter, the assessee, by an instrument dated 10.09.1970 styled as lease-cum-licence, granted a mining lease in favour of a company. A question arose whether such a transaction would amount to transferring a capital asset thereby attracting capital gains? The point argued by the assessee before the court was that the transfer by way of lease must stand excluded from the transfer as defined under sub-section (47) of section 2 of the Income Tax Act. A Division Bench of this court negatived the point raised by the assessee. This court held that the right conferred on a lessee under a lease deed is a capital asset in the hands of the lessor. In 117 ITR Pg.581 referred to above, the assessee was a tenant, whose rights were protected under the West Bengal Tenancy

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Act, 1956. However, due to a tripartite agreement entered into by him, the lessor and the proposed sub-lessee, he had extinguished his rights, as a result of which, the proposed party became the lessee of the property. The Calcutta High Court held that surrender of rights of the assessee referred to above would amount to extinguishment of his rights in the land/capital asset and therefore it attracts capital gains. This judgment was affirmed by the Supreme Court in 192 ITR Pg.382. In 172 ITR Pg.311, a Hindu Undivided Family was the assessee; they had agricultural lands belonging to an ancestor; later on, the property was developed into a residential zone; various extents of properties were leased for a period of 99 years and the lease document provided for termination of lease on stated failures by the lessee. For the assessment years mentioned therein, a large sum of money was received as salami. A question arose as to whether the transaction effected by the assessee would amount to transferring a capital asset warranting capital gains tax? The Supreme Court held that transfer by way of lease would amount to transfer of a capital asset and therefore tax is leviable as capital gains. From a reading of the above referred to judgment, it is clear that transfer by way of lease is treated as transfer of a capital asset on the principle that the lease creates an interest in the land and therefore to that extent, it extinguishes the right of the transferor. If the facts of the present case are analysed in the context of the law laid down by the Supreme Court and the various sections of the Income Tax Act, we have no difficulty at all in holding that when the assessee transfers his leasehold rights in the land in his occupation by way of a sub-lease to another person, it amounts to extinguishing his rights in the property and since his leasehold rights had created an interest in the land, i.e., enjoyment and possession and therefore it would definitely come within the definition of "capital asset" as defined under section 2(14) of the Income Tax Act. Whether the owner himself transfers by way of a lease or a lessee transfers by way of sub-lease, the principle remains the same, namely, in either action, there is extinguishment of rights.

6. In the light of our discussion referred to above, we are not inclined to agree with the judgment of the Income Tax appellate Tribunal as well as the Commissioner of Income Tax and accordingly restore the order of the Assessing Officer. The point of law raised by the Revenue in this appeal is answered in favour of the Revenue and against the assessee.

Vsl

Sd/
Asst.Registrar

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Sub Asst.Registrar

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To

1.The Commissioner of Income Tax, Madurai.

2.The Asst Registrar,
Income Tax Appellate Tribunal,
III Floor, Rajaji Bhavan,
Besant Nagar, Chennai 90.

3.The Deputy Commissioner of Income Tax,
Special Range I, Madurai.

4.The Commissioner of
Income Tax (A) I Madurai Range, Madurai

+ 1 cc to Mrs. Pushya Sitaraman, SSC (IT) SR No.10964

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SR/25.4.2006 TAX CASE (A) NO.366/2001

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